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INTRODUCING ENVIRONMENTAL, SOCIAL AND CORPORATE GOVERNANCE (ESG) IN A CORPORATE DISTRESS SCENARIO: THE EU OPPORTUNITIES AND RISKS[1]

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Abstract

In the last few decades, there is a lot of legislative and soft law instruments and policies on environmental, social and governance (hereinafter: ESG) elements. Althoughth, mentioned intruments and polices do not directly apply to the distress scenario, according to the existing regulation, EU insolvency practitioners, directors, debtors, creditors, insolvency courts, competent authorities, and other stakeholder must in a wider context apply ESG standards regardless of whether they are at the pre-bankruptcy proceedings, bankruptcy with liquidation, or in restructuring with a bankruptcy plan. This paper first explains the relevant terms and their synonyms and moves on to define ESG issues and why they may be relevant in corporate distress

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scenarios. Next, it analyzes the existing international and European binding and soft-law regulatory framework related to ESG and insolvency law. The regulatory framework is the starting point for answering the question of whether ESG goals can be applied to corporate distress scenarios, and if so, how it can be accomplished in practice within the framework of the traditional objectives of pre-bankruptcy proceedings, bankruptcy with liquidation, and restructuring with a bankruptcy plan. Therefore, the central part of this paper assesses and critically analyzes the risks and opportunities that can arise from the introduction of ESG elements in corporate distress scenarios. The concluding section provides an overview of the status quo, with recommendations for future development. The authors conclude that the introduction of ESG elements in a distress scenartio is not always an option. However, if the introduction of ESG goals are carefully examined and implemented in the appropriate type of insolvency proceedings, it may bring many benefits to all insolvency stakeholders.

***Keywords**: ESG, CSR, non-financial sustainability, sustainable, distress, pre-bankruptcy, bankruptcy, bankruptcy*

1 ESG IN A CORPORATE DISTRESS SCENARIO: WHY IT MAY BE IMPORTANT?

Environmental, social, and corporate governance (hereinafter: ESG) principles have become one of the key factors in corporate management and operations at the international and EU levels (Fornasari & Traversi, 2024, p. 117; Brondoni & Plata, 2022, p. 1-2). Therefore, corporate operations solely focused on profits are no longer the only focus of enterprises, but the market is increasingly turning towards management and operations, which are geared towards non-financial sustainability, i.e., the protection and reporting oo environmental, social, and corporate governance principles (Fornasari & Traversi, 2024, p. 117; Brondoni & Plata, 2022, p. 1-2).

Many international, EU, and national non-governmental organizations (NGOs) have developed soft law tools that promote the implementation of ESG in all aspects of business operations. In this sense, it is worth noting the significance of the 2030 Agenda for Sustainable Development (United Nations n.d.; Fornasari & Traversi, 2024, p. 119), the European Green Deal (European Commission, n.d.b), CSRD directive (European Union, 2022;), as well as the work of numerous international and national bank authorities, in promoting ESG policies (see also: Tuula, 2019, p. 211-213).

However, these documents and efforts do not provide a clear answer on how to implement ESG principles in enterprises facing distress scenarios (Tuula, 2019, p. 212). The issues lay in the hyperproduction of new ESG rules in these documents, but only at the level of principles. As such, they do not answer the question of how to promote and proceed with ESG policies in pre-bankruptcy, bankruptcy proceedings with liquidation and corporate restructuring. These issues are the center of attention in the EU, as one of the most prominent promoters of ESG objectives (in this context, see: Tuula, 2019, p. 212; Tuula, 2020, pp. 1-5).

This situation opens numerous questions that have not been discussed systematically before (Tuula, 2019, p. 212). For example, how will insolvency practitioners, directors, debtors, creditors, insolvency courts, competent authorities and other stakeholders ensure compliance with ESG principles, along with their regular duties and obligations in such proceedings. In other words, how will an enterprise operating in the so-called brown industry, or based on the production of fossil fuels which finds itself in financial distress, obtain a loan for restructuring if EU banks are prohibited from supporting enterprises which are not compliant with ESG objectives, or do not operate in sustainable industries and sectors. Furthermore, there is a question of how ESG standards can be applied in corporate distress scenarios to enterprises without sufficient funds to cover employee salaries, where it is reasonable to expect creditors prioritize their private interests (the enforcement of their claims against the debtor) over public interests (environmental protection, protection of social rights, inclusive and non-discriminatory governance) (Tuula, 2019, p. 212, 225).

This paper is limited to the analysis of corporate insolvency, i.e., only the three most common procedures which enterprises can face, i.e., pre-bankruptcy proceedings, bankruptcy with liquidation and restructuring with a bankruptcy plan (hereinafter: restructuring). The distress scenarios in this paper refer to the three mentioned bankruptcy procedures: prebankruptcy proceedings, bankruptcy with liquidation and restructuring with bankruptcy plan.

In the first part of the paper, authors define the terms, acronyms and synonyms relevant for this topic. Then it outlines the importance of ESG factors in corporate distress scenarios and why they may be important in prebankruptcy proceedings, bankruptcy with liquidation and restructuring. The paper then analyses the relevant legal framework. The following sections move to the central question of how to apply ESG policies to corporate distress scenarios, i.e., how insolvency practitioners and other stakeholders may introduce and promote such policies in a corporate distress scenario. The paper will identify possible differences in accomplishing better outcomes of insolvency proceedings, while also cautioning against harmful risks which may emerge in this context. The paper concludes by outlining the conducted analysis, with

clear guidelines for further work and highlights possible obstacles in the process of integrating ESG in distress scenarios.

2 TERMINOLOGY AND ACRONYMS

Literature often references various terms and acronyms which are treated equally in public and often used interchangeably. Such terms and acronyms in frequent use include: business sustainability (BS), corporate social responsibility (CSR), environmental, social and corporate governance (ESC) and environmental, social and corporate, ethical governance (ESEG). Although these are related terms, their meaning is substantively distinct (in this context see: Tuula, 2020, p. 2).

The market and its participants have traditionally been oriented towards attaining financial sustainability, focused on maximizing profits (Brondoni & Plata, 2022, p. 1; for evolution of non-financial sustainability see: Fornasari & Traversi, 2024, p. 119). However, with the accomplishment of civilization milestones and human rights in the broader sense (including the right to the protection of the environment, labour rights, consumer rights, individual rights and data protection rights) the focus has increasingly shifted to the impact of enterprises on the society, environment and other elements of community life. Fornasari & Traversi, 2024, p. 119-120). Therefore, contemporary business sustainability (BS) covers both financial and non-financial sustainability (Tuula, 2021, p. 163; Tuula, 2020, p. 2).

Financial sustainability comprises "*financial* economic sustainability performance (ESP)" (Tuula, 2020, p. 2), i.e., it is geared towards attaining the best financial results and reflecting the highest profits in financial reports.

Non-financial sustainability is composed of "environmental, social, ethical, and governance (ESEG)." It is not profit oriented, and focuses on the impact of the enterprise on other aspects of business operations (Tuula, 2020, p. 2; European Commission. (n.d.a).

The meaning of the term non-financial sustainability has evolved over the years and continues to evolve to include other impacts of the enterprises. As a concept, non-financial sustainability was first used in 1987, in the Brundtland-Commission's Report which stated that enterprises should include other non-financial aspects in their operations (World Commission on Environment and Development [WCED], 1987; Tuula, 2020 p. 2.).

The first legislative entry point of CSR, as an aspect of non-financial sustainability, was the term CSR introduced by the European Commission (Tuula, 2019, p. 213). This is a term that represents the impact of enterprises on

the society (Tuula, 2020, p. 2; Tuula, 2019, p. 212-213, for strategic CSR`s principles see: Vevere & Brante, 2020, p. 222-223). Over time, this concept has spread to the environmental, societal and governance impact of enterprises (Grygiel-Tomaszewska & Turek, 2021, p. 28, Johnson et al., 2019). The environmental aspect usually includes the following issues: climate change, protection of the environment, biodiversity, and net zero tolerance (CFA Institute, 2015, p. 4). Social aspects include gender equality and diversity, data protection, consumer protection and satisfaction, protection of human rights, and labour standards (CFA Institute, 2015, p. 4;). Governance aspect includes board composition, lobbying, corruption, audit and monitoring processes (CFA Institute, 2015, p. 4 for social segment see also: (Gjurovski, Jelisavac Trošić & Arnaudov, 2024, p. 301-302).

). ESG objectives are directed towards long-term, rather than short-term strategies with the aim that possible negative effects of the company`s operations today would not be negatively reflected on future generations. (Grygiel-Tomaszewska & Turek, 2021, p. 28, Johnson et al., 2019).

3 RELATED GLOBAL TRENDS, LEGISLATIVE AND SOFT LAW INSTRUMENTS

3.1 INTERNATIONAL TRENDS

The implementation of ESG objectives into national legislation is intensively promoted at the international level. This is primarily done through soft-law tools, which are legally non-binding instruments, but which are of great significance in practice because they are adopted by eminent international and national organizations (Goldmann, 2012, p. 335, see also evolution of non-financial reporting: Fornasari & Traversi, 2024, p. 119-120).

The UN is the most prominent international organization to adopt ESG soft law tools, adopting the 2030 Agenda for Sustainable Development in 2015 (United Nations, n.d.; Weiland, Hickmann, Lederer, Marquardt, & Schwindenhammer, 2021, p. 91). The agenda introduces 17 goals which should be accomplished by 2030, and which are aimed at promoting sustainable development (United Nations, n.d.). This includes the protection and preservation of the environment through renewable energy, the promotion of equality among states and providing equal opportunities for all, the promotion of cooperation between states, gender inclusiveness, the development of least developed states, as week as balancing environmental, economic and social sustainability (United Nations, n.d.; Weiland, Hickmann, Lederer, Marquardt, & Schwindenhammer, 2021, p. 91; Tuula, 2019, p. 211).

The abovementioned goals are significant in the context of implementing the ESG standards in insolvency because they are soft law tools adopted by one of the most influential international organizations in the world. Therefore, this

agenda places a significant regulatory pressure on UN member states to reduce the risk of environmental catastrophes and social crisis. UN members pursue these aims through a variety of policies, especially through regulations in the banking sector by imposing the obligation on financial institutions to give loans and to invest only in sustainable enterprises. All of this ultimately reduces the likelihood that an enterprise in financial distress, which is not compliant with the 2030 Agenda for Sustainable development and its goals, will be able to find new sources of financing from investors. (similar to this: Fornasari & Traversi, 2024, p. 120-121; Tuula, 2019, p. 211 and 227; for other soft law tools see also: UN Environment Programme Finance Initiative, n.d.a; UN Environment Programme Finance Initiative, n.d.b; UNEP Finance Initiative, n.d.c; UNEP Finance Initiative, n.d.d).

Furthermore, there is the UN Environment Programme Finance Initiative that promotes compliance with and attainment of net zero emissions through the gradual reduction of emissions by promoting so-called green investments and loans, transparent reporting and support for green transition, as well as decision-making aimed at sustainable and not only financial development. This is accomplished by the compliance of all members of the alliance with the regulatory requirements and initiatives introduced by the Alliance (UN Environment Programme Finance Initiative, n.d.a; UN Environment Programme Finance Initiative, n.d.b; UNEP Finance Initiative, n.d.c; UNEP Finance Initiative, n.d.d).

3.2 EUROPEAN UNION

3.2.1 LEGISLATION RELATED TO ESG

The EU has positioned itself at the international level as one of the leading proponents and the political entity most actively implementing ESG policies into its legislation, spilling over into the national legislation of its member states (in this context see: Baumüller & Grbenic, 2021, p. 370-371; Fornasari & Traversi, 2024, p. 119-120, etc.).

Notable legislative acts in this context include the Treaty of Functioning of European Union (hereinafter: TFEU) (European Union, 2016), which references ESG as a matter of principle in multiple provisions (for example in Article 11 of the TFEU, Article 3(3) of the TFEU etc.) (Tuula, 2020, pp. 19-20; European Union, 2016). For instance, Article 11 TFEU establishes the obligation of the EU to implement policies for environmental protection and preservation in its policies and legislation in order to attain sustainable development (European Union, 2016, Art. 11). Article **3(3) TFEU promotes sustainable goals of the EU such as social rights, fair market cometition,**

promotion and protection of social rights. (European Union, 2016, Art. 3(3); Tuula, 2020, p. 19).

One of the key documents in promotion of ESG goals on the EU market is the European Green Deal from 2019 (European Commission. (n.d.b). The main idea of the European Green Deal is the achievement of full climate neutrality by 2050. This is a very ambitious plan of the EU which includes all elements of ESG. Some of the main ESG goals are the promotion of new, so called green workplaces, promoting socially responsible and transparent governance through ESG reporting in order to provide a clearer picture of compliance with ESG goals, not only by investors, but also their partners and the ultimate consumers (Tuula, 2020, p. 20; European Commission, 2024; Ström, 2020, pp. 2, 4 and 8). The EU Green Deal accomplishes ESG goals by applying normative pressure on market stakeholders.(Ström, 2020, pp. 2, 4 and 8).

The EU is active in the ESG context through its secondary legislation as well, including, for example, the Corporate Sustainable Reporting Directive (European Union, 2022: Baumüller & Grbenic, 2021, p. 370-371; Fornasari & Traversi, 2024, p. 122), the Taxonomy regulation (European Union, 2020; Baumüller & Grbenic, 2021, p. 370-371), and the recast MiFID II (European Union, 2021). These are secondary EU legislative acts which promote the implementation of ESG goals in all aspects of business operations, including the corporate distress scenarios.

The Corporate Sustainable Reporting Directive is one of the most significant EU legal sources on ESG goals, introducing the duty of enterprises to report on their ESG policies (European Union, 2022: Baumüller & Grbenic, 2021, p. 370-371; Fornasari & Traversi, 2024, p. 122). This duty includes reporting on the share of profits allocated to ESG goals (European Union, 2022).

The Taxonomy Regulation (European Union, 2020) is a crucial act which classifies sustainable environmental aspects of business activities. It also introduces the duty to report on the environmental sustainability for legal entities subject to the Regulation (Pacces, 2021, p. 3; European Union, 2020; Baumüller & Grbenic, 2021, p. 370-371). The regulation introduces the classification of sustainability which can be of key importance in bankruptcy proceedings, i.e., if the debtor in distress classifies as sustainable under the Regulation, it will have higher chances of obtaining green financing and green loans (European Union, 2020; Baumüller & Grbenic, 2021, p. 370-371).

In addition to the outlined sources, it is worth mentioning the Recast MiFID II Directive (European Union, 2021) as it introduces the duty to include ESG factors into the internal processes of investment decision-making for financial institutions. Thus, for example, if the legal entity invests in the restructuring of distressed enterprises, then the Recast MiFID II Directive requires the

consideration of ESG factors while making their investment decision. To improve transparency, the Regulation mandates the duty to inform on ESG risks for all entities investing in restructuring in the European Union, 2021). All of these issues are important for restructuring because ESG compliance simplifies and facilitates the search for investors to debtors in financial distress, thus enabling them to obtain loans with more favourable conditions and lower interest rates (European Union, 2021).

In addition to the outlined efforts in the context of the business community and insolvency, the European Banking Authority (European Banking Authority, 2022) is also making significant contributions. This is an umbrella EU organization for financial institutions which adopted the Final guidelines on the management of ESG risks in January 2025 (European Banking Authority, 2025). The aim of the guidelines is to manage ESG risks in the short-, middle-, and long-term business period of financial institutions on the EU capital market. Since the EU is making the ambitious step of fully transitioning to sustainable business operations, ESG risks are rapidly increasing. Thus, the Guidelines provide for internal controls which financial institutions must conduct in accordance with the Directive on Capital Requirements (European Parliament & Council of the European Union, 2013; European Banking Authority, 2025). According to the guidelines, in the practical sense, legal entities which provide publicly available information about ESG factors will be granted higher ratings than those which do not publish such data (European Parliament & Council of the European Union, 2013; European Banking Authority, 2025).

3.2.2 LEGISLATION RELATED TO THE EU INSOLVENCY LAW

Insolvency laws at the EU level are the competence of the member states, so there are currently 27 different national legislatures regulating this subject matter (European Commission. (n.d.c). There are already several documents at the EU level regulating insolvency law, primarily the so-called Recast Insolvency Regulation (European Union, 2015) which addresses cross-border issues between EU member states and introduces rules for their facilitation. The other act dedicated to insolvency law at the EU level is the so-called Directive on Preventive Restructuring which has the objective of creating a harmonized legal framework for the prevention of distress within the EU (European Union, 2019; Tuula, 2021, pp. 163-164). Although the Directive does not expressly mention ESG factors, its careful reading reveals that it promotes internal and external sustainability. Internal sustainability is reflected in the promotion of continuing the debtors' viable business operations, while external sustainability promotes informal restructuring in order to avoid unnecessary administration (Tuula, 2020, p.5; Tuula, 2019, p. 228-229).

The national implementations of the Directive on Preventive Restructuring are more or less silent with regards to the implementation of ESG goals (for Croatia see: Narodne novine, 2015).

In addition to these instruments, the adoption of the so-called Insolvency III Directive has been announced (European Commission, 2022), which will address the substantive aspects of the harmonization of insolvency law among EU member states.

Therefore, the abovementioned acts do not provide answers on how to implement ESG in distress scenarios.

3.3 ASSESSMENT OF THE STATUS QUO

The analysis of the international and EU sources and legislation related to ESG clearly shows that the relevant acts promote ESG, thus enabling enterprises to remain familiar with the newest trends and policies, and to make their decisions in alignment with the results of the ESG reports.

There are multiple normative acts at the EU level introducing reporting obligations on enterprises with regard to compliance with ESG goals, the profit allocated to reaching ESG goals, whether they can qualify as green. This is relevant in the context of implementing ESG in restructuring, since debtors in distress that have successfully adapted will have a better basis for implementing ESG goals in distress scenarios (similar to this: Tuula, 2019).

However, all the referenced instruments address ESG goals only in principle, and none of them expressly define their implementation in distress scenarios. This opens numerous legal questions which can be categorized into several groups.

The first group addresses the question of how to reconcile the traditional (national) objectives of bankruptcy proceedings which are primarily aimed at either the monetization of the debtors' assets for the collective compensation to the creditors, or resuming the operations of the debtor after the pre-bankruptcy reconstruction process, with the ESG goals which are open to long-term strategies and generally require significant financial assets. ESG goals are by nature contrary to creditor interests since they are aimed at public interests, rather than the private, mostly financial, interests of creditors (In that sense see: Tuula, 2019, p. 215).

The second group of questions deals with ways to convince creditors to subordinate their private interest in maximizing the recovery of their claim in bankruptcy proceedings to the public interests of environmental protection, promoting social rights and the establishment of corporate governance aimed

at promoting the reduction of corruption, and improving the inclusiveness of endangered and minority groups (In that sense see: Tuula, 2019, p. 217, 220-222; Tuula, pp- 23-25).

The third group of open questions addresses the preparation of insolvency practitioners, creditors, debtors, national authorities and other stakeholders in the absence of harmonized procedures, either in national or EU legislation on the implementation of ESG in insolvency. (In that sense see: Tuula, 2019, pp. 223-224).

None of these questions can be answered without testing whether it is even possible to implement ESG in all bankruptcy proceedings, and if so, the measure of its feasibility and applicability. The following section addresses this particular question, as well as the possible challenges which may arise in this context. The analysis is focused on the EU, since it has made the longest strides in adopting and implementing ESG legislation, compared to other countries and organizations in the world.

4 ESG IN INSOLVENCY PROCEEDINGS

4.1 ESG IN BANKRUPTCY WITH LIQIDATION

ESG implementation can be the starting point for the selection of the type of bankruptcy proceedings to be conducted over the debtor. Therefore, for example, the attainment of ESG goals can be key to the decision on whether the debtor will be subject to bankruptcy with liquidation, pre-bankruptcy proceedings or restructuring (Tuula, 2021, p. 164).

In this sense, it is clear that in the classic bankruptcy proceedings with liquidation, ESG policies cannot be implemented to the degree it would be possible in pre-bankruptcy with liquidation or restructuring. The main obstacle to the implementation of ESG in bankruptcy with liquidation is its ultimate objective of winding down the debtor, which inherently relies on short-term strategies and the financial compensation of the creditors. As previously noted, bankruptcy with liquidation ultimately aims to monetize the assets of the debtor for the collective compensation of the creditor, which subsequently ceases to exist. Under such conditions, there is a low likelihood that ESG goals can be promoted, because private interests of the creditors will hold primacy over public interests (Tuula, 2019, pp. 216-222).

Nevertheless, although less frequently and with more difficulty, one can imagine situations where ESG goals will be implemented within the framework of bankruptcy with liquidation. For example, this would be the case for debtors operating in the so-called brown industries, where, after the winding down of the enterprise, harmful plants, factories, machinery and chemicals have to be secured in order to prevent natural disasters. In such cases, all the stakeholders in the bankruptcy with liquidation must comply with ESG goals, particularly

environmental protection. (In that sense see: Tuula, 2021, pp. 164-165; Tuula, 2019, pp. 216).

4.2 ESG IN PRE-BANKRUPTCY PROCEEDINGS AND RESTRUCTURING

The goal of pre-bankruptcy proceedings and restructuring is to give a new chance to the debtor. Therefore, ESG goals in pre-bankruptcy proceedings and restructuring can be implemented more easily and in a simpler manner. Although there are many contrasting interests to consider in these proceedings, such as the private interests of individual groups of creditors, reaching ESG goals still remains not only possible, but also desirable. (In that sense see: Tulla, 2019, pp. 222).

In pre-bankruptcy proceedings and restructuring, decisions are traditionally based on long-term and not short-term strategies. As a rule, long-term strategies initially require significant financial expenditures, and the investment of high levels of know-how and resources into a business whose financial benefits will possibly materialize in the future. Pre-bankruptcy proceedings and restructuring similarly commence without certainty that the continuation of the business operations will be realized in practice. Therefore, the decision to conduct pre-bankruptcy proceedings and restructuring should be made in a timely manner, followed by collecting sufficient votes from the creditors in order to adopt the pre-bankruptcy and restructuring plans. In addition, there should be a competent insolvency practitioner who will be able to conduct the phases of the relevant proceedings. The final and most important issue is to find investment banks which will decide to take the risk of financing the enterprise in financial distress. (In that sense see: Tulla, 2019, pp. 222).

In this sense, it is important to consider several insolvency tests, including the viability test (Tuula, 2021, p. 164) and the best interest of creditors test (BIT) (Tuula, 2019, p. 225), as well as the private creditor investment test (Šimunović, 2024, p. 213).

The viability test is aimed at maintenance, i.e., the possibility of continuing the operations of the debtor. Traditionally this test has been oriented towards financial indicators, i.e., the assessment of whether the continuation of the operations of the enterprise will result in more profits than liabilities (Tuula, 2019, p. 225). This is confirmed by EU legislation in Article 4(3) of the Recast Insolvency Regulation which provides that the debtor must be viable under national law. The results of the test must show that the debtor will return to the market and recover after the restructuring proceedings (Tuula, 2022, p. 7; Tuula, 2021, p. 164; European Union, 2015, Art. 4 par. 3). However, with the inclusion of ESG goals in the pre-bankruptcy and restructuring process, the concept of the viability test would change in its objective from strictly financial

viability to include environmental, social and governance wellbeing (Tuula, 2019, p. 225).

The BIT test assesses whether the creditors which voted against the plans in the pre-bankruptcy proceedings and restructuring would be put in a worse situation than they would have been in a classic bankruptcy with liquidation (Tuula, 2019, p. 225; Tuula, 2021, p. 164;Krohn, 2020, pp. 83-84). The same conclusions apply here as in the viability test. ESG in pre-bankruptcy proceedings and restructuring could accomplish the same, if not better position of creditors than they would have had in a bankruptcy with liquidation, but only under the condition that the viability assessment of these insolvency proceedings is considered as part of the long-term strategy (Tuula, 2019, pp. 225).

The private creditor test is used in EU insolvency proceedings in situations where it must be determined whether the conduct of a member state as a creditor in insolvency proceedings represents illegal state aid under Article 107(1) of the TFEU. It is commonly used when a state in the pre-bankruptcy proceedings and restructuring votes in favour of the continuation of the operations of the debtor, thereby agreeing to their release from tax debt. Under normal circumstances, such conduct would qualify as illegal state aid, but it is allowed under some circumstances in insolvency proceedings. The private creditor test determines whether a different private creditor would act the same in insolvency proceedings in the same situation and circumstances as the creditor state (Šimunović, 2024, p. 213). For example, it takes into consideration the assessed status of the insolvency proceedings, the costs of the sale of the assets, the amount which could eventually be generated from the sale of insolvency estate (the so-called discounted price, and not the accounting assessment of the value of the debtor's property) (Šimunović, 2024, p. 214-215). When ESG goals and the private creditor test are applied in financial distress scenarios, the state should be even more interested in reaching ESG goals and policies. EU member states are obliged to implement ESG goals into their national legislation, in accordance with international and EU documents. Thus, their conduct in insolvency proceedings must also be aimed at the realization of such policies. Therefore, member states should pursue ESG goals in distress scenarios even more than other creditors under the private creditor test, as part of their duties to protect the environment and promote the protection of social rights and sustainable governance.

In the EU, all three tests (the viability test, the BIT and private creditor test) are still analysed, with some exceptions, in the traditional context and their results in the pre-bankruptcy and restructuring are exclusively focused on profit and financial viability (Tuula, 2020, p. 7).

In addition to the abovementioned tests, the implementation of EGS in a distress scenario can be central to the decision on whether the relevant proceedings will result in the sale of the debtor's property (piecemeal

liquidation) or the sale of the debtor's business (parts of it or the whole business) as a going concern (Tuula, 2020, p. 3). These decisions can easily integrate ESG goals in the pre-bankruptcy proceedings and are more willing to support a business which is sustainable and compliant with ESG goals, than one which is more financially profitable, but does not contain a long-term ESG strategy (Tuula, 2020, p. 3).

As the preceding analysis has found that ESG goals are more feasible in the pre-bankruptcy and restructuring, the following section analyses the opportunities and risks in the process of integrating ESG goals in those proceedings (Tuula, 2020, p. 3).

5 POSSIBLE OPPORTINITIES IN THE PROCESS OF INTEGRATING ESG GOALS INTO PRE-BANKRUPTCY PROCEEDINGS AND RESTRUCTURING

As noted above, ESG goals and strategies in pre-bankruptcy proceedings and restructuring may have many positive impacts for the enterprises, as there are many opportunities created for the debtors in the process. This relates primarily to the access to new fundings and new types of funding pools, such as green loans and others related to sustainability. These are investments which may not have been available to the debtors had they not opted for ESG goals in pre-bankruptcy and restructuring. Otherwise, the enterprise in distress would have been deemed ineligible during the assessment of their credit capacity as an unviable entity. As stated previously, all global and European governmental and non-governmental financial institutions are increasingly financing ESG policies and granting loans under significantly reduced and more lenient conditions with lower interest rates and conditions for repayment, than would be the case for classic debtors which are unwilling to adopt the ESG goals (Tuula, 2019, p. 217,-222, 225-228; Tuula, 2020, pp. 7-12; Tuula, 2021, p. 166-168).

ESG in pre-bankruptcy proceedings and restructuring can be an excellent opportunity for the recovery of assets and the value of the enterprise, the creation of a new brand and attracting new customers. Following pre-bankruptcy and restructuring procedures, each debtor which survived financial distress faces reputational damage which negatively impacts its partners and ultimate users of the goods and services it places on the market. In other words, an enterprise in distress has to attract buyers and users anew, and marketing its goods and services compliant with ESG provides the debtor a new opportunity on the market not only to recover previous buyers and users, but to attract new ones as well (Similar to this: Tuula, 2020, p. 7).

Furthermore, the debtor will win back the confidence of its business partners, garner creditor and stakeholder support, after introducing ESG goals into the abovementioned insolvency procedures. Pre-bankruptcy proceedings and restructuring with ESG goals may build effective boards, introduce new systems of early warning tools in the debtor's company and create opportunities for other types of long-term strategies. This will all reflect not only on the business aspect, a relation with third parties, but also within the enterprise itself, which can enable the creation of better working conditions and atmosphere in the workplace.

This all can lead to increased profits, although initially profits appeared to be a secondary consideration to ESG goals, which were treated as the main objective of the pre-bankruptcy proceedings and restructuring. (Tuula, 2019, p. 230-232).

6 RELATED RISKS

Despite the numerous opportunities, there are certainly numerous risks and weaknesses which require consideration. As previously noted, it should be emphasized that ESG in insolvency proceedings is not always an option due to the pluralism of interests and costs (similar: Tuula, 2019, p. 231).

Furthermore, ESG-related reporting, monitoring, measuring, due diligence is still subject to manipulation in the market. Some of the most common types of manipulations include greenwashing, falsely representing the positive impacts of certain products or services. Greenwashing can be directly linked to reputational and litigation risks (Similar also: Tuula, 2020, p.7).

Furthermore, the key performance indicators (so-called KPIs) currently available on the market are based on estimations but not on all the available data. There is also a lack of the relevant non-financial/ESG information crucial for long-term profitability, as well as of appropriate ESG products on the market, e.g., insurance products, or evaluation of ESG reports. (for the evaluation of ESG scores see: (Lohmann, Möllenhoff, & Lehner, 2024, p. 3-5).

All of this represents a serious obstacle to the full implementation of ESG in the analysed insolvency proceedings. However, this should not be discouraging, rather it should motivate additional education of insolvency practitioners, debtors, creditors, and their full and adequate application in practice will require time. (In that line see: Tuula, 2019, p. 230-232; Tuula, 2020, p. 36; Tuula, 2021, p. 167).

7 CONCLUSION

The impact of ESG factors in distress scenarios is greater than ever, orienting more and more investor attention to the non-financial sustainability in such situations, including ESG reporting, ESG disclosure requirements, ESG ratings, ESG due diligence that are based and measured on available data and comparable standards, insistence on verification by a third party.

There are numerous examples of ESG-related legally binding and soft law tool instruments at the international and national levels. At the EU level alone, there are 27 national legislations and several documents which regulate insolvency issues, but these documents currently do not provide a clear vision of how to implement ESG goals in financial distress scenarios.

The conducted analysis found that the implementation of the ESG goals in distress scenarios is not always an option. For example, there is a higher likelihood that ESG goals will be met in pre-bankruptcy proceedings and in restructuring than in insolvency proceedings with liquidation. In addition, in insolvency proceedings, there is an assessment of whether it is better to sell the debtor's property in whole or in part, and whether a long-term or short-term strategy will be conducted.

Furthermore, there is a need to conduct insolvency tests, a viability test, a BIT and private creditor test and to assess how ESG strategies can be integrated into the analysis of such tests.

Thus, on the one hand, the implementation of ESG into pre-bankruptcy proceedings and restructuring can attract new buyers and investors, the production of new products and provision of new services by the distressed, a better understanding of business partners and creditors, and improve the work atmosphere in the debtor's enterprise.

On the other hand, the implementation of ESG in insolvency proceedings brings a significant risk of greenwashing and related reputational and litigation risks. An additional issue is the lack of existing ESG ratings, ESG insurance products, and evaluation of ESG reports.

In this sense, the assessment of the possible positive and negative impacts for enterprises in case of the implementation of ESG in restructuring showed that there are many potential benefits, not only for the insolvency debtor and creditors, but also for other stakeholders. In the long-term strategy, ESG in distress scenarios may also bring higher profits. However, this positive outcome cannot always be guaranteed, and there is a risk of determining liability for damages in case of an unsuccessful outcome.

It remains to be seen how these issues will develop in the future and whether in the future public interest will override the creditors' rights and stakeholders' interests, or if creditors' returns will override public interest such as environmental protection or reduction of gas emissions (Tuula, 2019, p. 231).

The answers are not available at the moment, but these questions of whether we should change the traditional objectives of insolvency proceedings to reach ESG goals. It appears to be too soon to make such extreme decisions. However, the hyperproduction of ESG regulations creates risks that we will be forced to change the objectives of insolvency and direct them primarily towards meeting ESG requirements and not the rights of creditors This is not necessarily problematic if these objectives overlap, however, the situation on the market shows that the interests of the creditors, i.e., the compensation of their financial claims, remain the prevailing guide of strategic planning in insolvency proceedings.

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